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Proposed statement of position : Reporting of investment contracts held by health and welfare benefit plans and defined-contribution pension plans : (proposed amendment to AICPA Audit and accounting guide Audits of employee benefit plans and SOP 92-6, Accounting and reporting by health and welfare benefit plans, September 15, 1993 ;Reporting of investment contracts held by health and welfare benefit plans and defined-contribution pension plans : (proposed amendment to AICPA Audit and accounting guide Audits of employee benefit plans and SOP 92-6, Accounting and reporting by health and welfare benefit plans,

September 15, 1993; Exposure draft (American Institute of Certified Public Accountants), 1993, Sept. 15

American Institute of Certified Public Accountants. Employee Benefit Plans Committee

EXPOSURE DRAFT

PROPOSED STATEMENT OF POSITION

REPORTING OF INVESTMENT CONTRACTS HELD BY HEALTH AND WELFARE BENEFIT PLANS AND DEFINED-CONTRIBUTION PENSION PLANS

(Proposed Amendment to AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* and SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*)

SEPTEMBER 15, 1993

Prepared by the Employee Benefit Plans Committee
Federal Government Division
American Institute of Certified Public Accountants

Comments should be received by December 15, 1993, and addressed to
Susan W. Hicks, Technical Manager, Federal Government Division, File Q-1-505,
AICPA, 1455 Pennsylvania Avenue, N.W., Washington, D.C. 20004-1081

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SUMMARY

This proposed statement of position (SOP) would amend chapters 3, 4, and 7 of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans*, with conforming changes as of May 1, 1993 (hereafter referred to as the Guide) and SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*.

This proposed SOP generally specifies the accounting for health and welfare benefit plans and defined-contribution pension plans for investment contracts issued by either an insurance enterprise or other entity. Defined-contribution plans, including both health and welfare, and pension plans, should report investment contracts with *fully benefit responsive* features (as defined in the proposed SOP) at contract value and other investment contracts at fair value. Defined-benefit health and welfare benefit plans should report investment contracts at fair value. This proposed SOP also permits health and welfare benefit plans and defined-contribution pension plans to report contracts that incorporate mortality or morbidity risk at contract value.

This proposed SOP is effective for financial statements for plan years beginning after December 15, 1993. Accounting changes adopted to conform to the provisions of this proposed SOP should be made as of the beginning of the year in which the change is adopted. The financial statements should disclose the change and the effect of the change on the financial statements. Restatement of financial statements of prior years is not permitted.

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September 15, 1993

Accompanying this letter is an exposure draft of an AICPA proposed Statement of Position (SOP), *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans*. A summary of the proposed SOP also accompanies this letter.

The proposed SOP was developed to assist accounting practitioners and auditors in the preparation of financial statements of health and welfare benefit plans and defined-contribution pension plans.

The purpose of the exposure draft is to solicit comments from preparers, auditors, and users of financial statements of health and welfare benefit plans and defined-contribution pension plans and from other interested parties. The proposed SOP would amend chapters 3, 4, and 7 of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* and SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*.

Comments or suggestions on any aspect of this exposure draft will be appreciated. The Committee's consideration of responses will be helped if the comments refer to specific paragraph numbers and include reasons for any suggestions or comments. Commenters are requested to give particular attention to the proposed effective date and transition.

Consideration was given to requiring disclosure of a market rate of interest for fully benefit responsive contracts reported at contract value. Some believe this information would be useful to the primary users of defined-contribution plan financial statements and could affect their decision whether to withdraw from, borrow from, or transfer funds out of such contracts. However, the Committee could not reach a consensus on what the market rate should represent. For example, should the plan disclose the money market rate as of the most recent statement of net assets date, or the rate currently available to the plan for a hypothetical portfolio of contracts with the average quality, average duration, and product features similar to the contracts in the existing portfolio, or some other rate. Commenters are requested to give particular attention to the need to disclose a market rate of interest for fully benefit responsive contracts that are reported at contract value and, if so, what the rate should represent. The proposed SOP has no such disclosure requirement.

Commenters are also requested to give particular attention to the requirement to value investment contracts that are deemed not to be fully benefit responsive because of plan restrictions (see paragraph 10) at fair value. In particular, are there any ERISA or Internal Revenue Code implications that should be considered, and what, if any, additional disclosure requirements should be considered?

Responses should be addressed to Susan W. Hicks, Technical Manager, Federal Government Division, File Q-1-505, AICPA, 1455 Pennsylvania Avenue, N.W., Washington, DC 20004-1081, in time to be received by December 15, 1993.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the AICPA's offices for one year after January 15, 1994.

Sincerely,

David M. Walker
Chairman
Employee Benefit Plans Committee

Gerard L. Yarnall
Director
Audit and Accounting Guides

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The Employee Benefit Plans Committee gratefully acknowledges the contributions of Mary Ann Arlt, George Cowles, Victor Gallo, and Timothy P. Moran, ad hoc task force members.

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PROPOSED STATEMENT OF POSITION

REPORTING OF INVESTMENT CONTRACTS HELD BY HEALTH AND WELFARE BENEFIT PLANS AND DEFINED-CONTRIBUTION PENSION PLANS

INTRODUCTION

1. The AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* (the Guide) includes standards of financial accounting and reporting for the financial statements of health and welfare benefit plans and defined-contribution pension plans. The Guide states that plan investments are generally to be presented at their fair value at the reporting date. Paragraph 3.15 of the Guide states that "contracts with insurance companies are to be included as plan assets in the manner required by [the Employee Retirement Income Security Act of 1974] ERISA annual reporting requirements and are to be reported in a manner consistent with the requirements of [Department of Labor] DOL Form 5500 or 5500-C/R." Paragraph 4.10 of the Guide and paragraph 26 of AICPA Statement of Position (SOP) 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*, contain similar language. The instructions to DOL Forms 5500 and 5500-C/R permit unallocated insurance contracts to be reported either at fair value or amounts determined by the insurance company, that is, contract value. The Guide specifically excludes contract value reporting for investments in similar contracts issued by banks, saving institutions, or other financial institutions. Contract value generally equals the principal balance plus accrued interest.

2. The Financial Accounting Standards Board (FASB) has issued Statement of Financial Accounting Standards (FASB Statement) No. 110, *Reporting by Defined Benefit Pension Plans of Investment Contracts*, which requires defined-benefit pension plans to report investment contracts issued by either an insurance enterprise or other entity at fair value. It amends FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, to permit defined-benefit pension plans to report only contracts that incorporate mortality or morbidity risk at contract value. The FASB decided not to address the measurement of plan assets held by health and welfare benefit plans or defined-contribution pension plans. Instead, the FASB asked the AICPA, in view of its experience with those plans, to further address the appropriate reporting of investments held by those plans.

SCOPE

3. This SOP provides guidance on the reporting of investment and insurance contracts held by health and welfare benefit plans and defined-contribution pension plans. It applies to all health and welfare benefit plans and defined-contribution pension plans. The appendix provides guidance for determining the values of investment contracts held by defined-contribution plans, including both health and welfare, and pension plans; however, certain examples may also be useful in determining the fair value of investment contracts held by other types of plans.

FINANCIAL ACCOUNTING AND REPORTING

Reporting of Contracts

4. Defined-benefit health and welfare benefit plans should report investment contracts at fair value. Defined-contribution plans, including both health and welfare, and pension plans, should report fully benefit responsive investment contracts at contract value, which may or may not be equal to fair value, and all other investment contracts at fair value. If, however, plan management is aware that an event has occurred that may affect the value of a fully benefit responsive contract (for example, a decline in the creditworthiness of the contract issuer or third-party guarantor or the possibility of premature termination of the contract by the plan), pursuant to FASB Statement No. 5, *Accounting for Contingencies*, disclosure of the event or, in certain circumstances, reporting the investment at less than contract value may be appropriate.

5. Defined-benefit plans provide participants with a determinable benefit based on a formula provided for in the plan, whereas defined-contribution plans provide benefits based on amounts contributed to an employee's individual account plus or minus forfeitures, investment experience, and administrative expenses. The Internal Revenue Code generally requires that all investment experience under defined-contribution plans be allocated to individual account balances.

6. Consequently, information relevant to the primary users of defined-contribution plan financial statements — plan participants — is different from that which is relevant to users of defined-benefit plan financial statements. In defined-contribution plans, plan participants have a greater vested interest in monitoring the financial condition and operations of the plan since they bear investment risk under these plans and plan transactions can directly affect their benefits.

7. The primary objective of a defined-contribution plan's financial statements is to provide information that is useful in assessing the plan's present and future ability to pay benefits when they are due. In a defined-contribution plan, the plan's net assets available to pay benefits equal the sum of participants' individual account balances. Accordingly, benefits that can be paid by the plan when they are due relate to the value of the assets that may currently be made available to the individual participants.

8. Consistent with the objective of a defined-contribution plan's financial statements, plan assets of defined-contribution plans should be measured and reported at values that are meaningful to financial statement users. Information that is useful to plan participants includes the amount they would receive currently if they were to withdraw or borrow funds from or transfer funds within the plan.

9. A *fully benefit responsive* investment contract (whether with an insurance enterprise or other entity) provides a guarantee by a financially responsible third party of principal and previously accrued interest for liquidations, transfers, loans, or hardship withdrawals initiated by plan participants exercising their rights to withdraw, borrow, or transfer funds under the terms of the ongoing plan. From the perspectives of the participants, the contract value of a fully benefit responsive investment contract held by a plan is the amount they would receive if they were to initiate transactions under the terms of the ongoing plan.

10. For purposes of this SOP, benefit responsiveness is defined as the extent to which a contract's terms or related agreement and the plan itself permit and require withdrawals at contract value for benefit payments, loans, or transfers to other investment options offered to the participant by the plan. Investment contracts must transfer principal and accrued interest risk to a financially responsible third party (that is, they provide for all participant-initiated transactions

permitted by an ongoing plan at contract value with no conditions, limits, or restrictions) to be considered fully benefit responsive. The plan itself must also allow plan participants reasonable access to their funds. If access to funds is substantially restricted by plan provisions, investment contracts held by those plans may not be considered to be fully benefit responsive. For example, if plan participants are allowed access at contract value to all or a portion of their account balances only upon termination of their participation in the plan, it would not be considered reasonable access and, therefore, investment contracts held by that plan would generally not be deemed to be fully benefit responsive. If, however, a plan limits participants' access to their account balances to certain specified times during the plan year (for example, semiannually or quarterly) to control the administrative costs of the plan, that limitation generally would not affect the benefit responsiveness of the investment contracts held by that plan. If a plan holds multiple contracts, each contract should be evaluated individually for benefit responsiveness. Contracts that provide for prospective interest adjustments may still be fully benefit responsive provided that the terms of the contracts specify that the crediting interest rate cannot be less than zero.

11. Health and welfare benefit plans and defined-contribution pension plans should report insurance contracts in the same manner required by ERISA annual reporting requirements of DOL Form 5500 or 5500-C/R. For purposes of this SOP, the terms *insurance contract* and *investment contract* are used as those terms are described for accounting purposes in FASB Statements No. 60, *Accounting and Reporting by Insurance Enterprises*, and No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*.

Background

12. Paragraph 1 of FASB Statement No. 60 describes insurance contracts:

> The primary purpose of insurance is to provide economic protection from identified risks occurring or discovered within a specified period. Some types of risks insured include death, disability, property damage, injury to others, and business interruptions. Insurance transactions may be characterized generally by the following:
>
> a. The purchaser of an insurance contract makes an initial payment or deposit to the insurance enterprise in advance of the possible occurrence or discovery of an insured event.
>
> b. When the insurance contract is made, the insurance enterprise ordinarily does not know if, how much, or when amounts will be paid under the contract.

13. Paragraphs 7 and 8 of FASB Statement No. 97 describe insurance and investment contracts:

> Long-duration contracts that do not subject the insurance enterprise to risks arising from policyholder mortality or morbidity are referred to in this Statement as investment contracts. A mortality or morbidity risk is present if, under the terms of the contract, the enterprise is required to make payments or forego required premiums contingent upon the death or disability (in the case of annuity contracts) of a specific individual or group of individuals. A contract provision that allows the holder of a long-duration contract to purchase an annuity at a guaranteed price on settlement of the contract does not entail a mortality risk until the right to purchase is executed. If purchased, the annuity is a new contract to be evaluated on its own terms.

> Annuity contracts may require the insurance enterprise to make a number of payments that are not contingent upon the survival of the beneficiary, followed by payments that are made if the beneficiary is alive when the payments are due (often referred to as life-contingent payments). Such contracts are considered insurance contracts under this Statement and Statement 60 unless (*a*) the probability that life-contingent payments will be made is remote or (*b*) the present value of the expected life-contingent payments relative to the present value of all expected payments under the contract is insignificant. [Footnote references omitted.]

Disclosure Requirements

14. Defined-contribution plans, including both health and welfare, and pension plans, should disclose the following in connection with benefit responsive investment contracts in the aggregate by investment option:

a. The average yield for each period for which a statement of net assets available for benefits is presented

b. The crediting interest rate as of the date of each statement of net assets available for benefits presented

c. The amount of valuation reserves recorded to adjust contract amounts (for example, due to problems with the creditworthiness of the contract issuer or third-party guarantor)

Those plans should also provide a general description of the basis and frequency of determining crediting interest rate resets and any minimum crediting interest rate under the terms of the contracts and any limitations on guarantees (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives).

AMENDMENTS TO THE GUIDE

15. The Guide is amended as follows:

a. The parenthetical comment (*see paragraph 3.15 for special provisions concerning the valuation of contracts with insurance companies*) in paragraph 3.12 is replaced by (*see paragraph 3.13 for special provisions concerning the valuation of insurance contracts and paragraph 3.17 for special provisions concerning the valuation of fully benefit responsive investment contracts*).

b. The following paragraph is inserted as paragraph 3.13:

> Insurance contracts, as defined by FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, should be presented in the same manner as specified in the annual report filed by the plan with certain governmental agencies pursuant to ERISA; that is, either at fair value or at amounts determined by the insurance enterprise (contract value). Plans not subject to ERISA should present insurance contracts as if the plans were subject to the reporting requirements of ERISA.

c. Paragraph 3.13 is renumbered as paragraph 3.14. The second sentence of that paragraph is replaced by the following:

> Examples include real estate, mortgages, or other loans, including loans to participants of a 401(k) plan, restricted securities, unregistered securities, securities for which the market is thin, and nontransferable investment contracts.

d. Paragraph 3.14 is renumbered as paragraph 3.15.

e. Paragraph 3.15 is replaced by the following:

> 3.16 Defined-contribution pension plans provide benefits based on the amounts contributed to employees' individual accounts plus or minus forfeitures, investment experience, and administrative expenses. In such plans, plan participants have a vested interest in monitoring the financial condition and operations of the plan since they bear investment risk under these plans, and plan transactions can directly affect their benefits (for example, investment mix, and risk and return).
>
> 3.17 Plan assets of defined-contribution pension plans should be measured and reported at values that are meaningful to financial statement users, including plan participants. The contract value of a *fully benefit responsive* investment contract held by a plan is the amount a participant would receive if he or she were to initiate transactions under the terms of the ongoing plan. Defined-contribution pension plans should report fully benefit responsive investment contracts at contract value, which may or may not be equal to fair value. If, however, plan management is aware that an event has occurred that may affect the value of the contract (for example, a decline in the creditworthiness of the contract issuer or third-party guarantor or the possibility of premature termination of the contract by the plan), pursuant to FASB Statement No. 5, *Accounting for Contingencies*, disclosure of the event or, in certain circumstances, reporting the investment at less than contract value may be appropriate.
>
> 3.18 *Benefit responsiveness* is the extent to which a contract's terms permit and require withdrawals at contract value for benefit payments, loans, or transfers to other investment options offered to the participant by the plan. Investment contracts must transfer the risk of principal and accrued interest to a financially responsible third party (that is, they provide for all participant-initiated transactions permitted by an ongoing plan at contract value with no conditions, limits, or restrictions) to be considered fully benefit responsive. The plan itself must also allow plan participants reasonable access to their funds. If access to funds is substantially restricted by plan provisions, investment contracts held by those plans may not be considered to be fully benefit responsive. For example, if plan participants are allowed access at contract value to all or a portion of their account balances only upon termination of their participation in the plan, it would not be considered reasonable access and, therefore, investment contracts held by that plan would generally not be deemed to be fully benefit responsive. If, however, a plan limits participants' access to their account balances to certain specified times during the plan year (for example, semiannually or quarterly) to control the administrative costs of

the plan, that limitation generally would not affect the benefit responsiveness of the investment contracts held by that plan. Contracts that provide for prospective interest adjustments may still be fully benefit responsive provided that the terms of the contracts specify that the crediting interest rate cannot be less than zero.

f. The phrase *contracts with insurance companies* in paragraph 3.22 is replaced by *insurance contracts*.

g. The following is added to paragraph 3.23:

   o. For benefit responsive investment contracts in the aggregate by investment option —

      - The average yield for each period for which a statement of net assets available for benefits is presented.

      - The crediting interest rate as of the date of each statement of net assets available for benefits presented.

      - The amount of valuation reserves recorded to adjust contract amounts (for example, due to problems with the creditworthiness of the contract issuer or third-party guarantor).

   p. A general description of the basis and frequency of determining crediting interest rate resets and any minimum crediting interest rate under the terms of the contracts and any limitations on guarantees (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives) on benefit responsive investment contracts.

h. The parenthetical comment *(excluding contracts with insurance companies)* in paragraph 4.09 is replaced by *(excluding insurance contracts and fully benefit responsive investment contracts held by defined-contribution health and welfare plans)*.

i. Paragraph 4.10 is replaced by the following:

   4.10 Insurance contracts, as defined by FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, should be presented in the same manner as specified in the annual report filed by the plan with certain governmental agencies pursuant to ERISA; that is, either at fair value or at amounts determined by the insurance enterprise (contract value). Plans not subject to ERISA should present insurance contracts as if the plans were subject to the reporting requirements of ERISA.

   4.11 Investment contracts held by defined-benefit health and welfare benefit plans should be reported at their fair values.

   4.12 Defined-contribution health and welfare benefit plans provide benefits based on the amounts contributed to employees' individual accounts plus or minus forfeitures, investment experience, and administrative expenses. In such plans, plan participants have a vested interest in monitoring the financial condition and operations of the plan since they bear investment risk under these plans, and plan transactions can directly affect their benefits (for example, investment mix, and risk and return).

4.13 Plan assets of defined-contribution health and welfare benefit plans should be measured and reported at values that are meaningful to financial statement users including plan participants. The contract value of a *fully benefit responsive* investment contract held by a defined-contribution health and welfare benefit plan is the amount a participant would receive if he or she were to initiate transactions under the terms of the ongoing plan. Defined-contribution health and welfare plans should report fully benefit responsive investment contracts at contract value, which may or may not be equal to fair value. If, however, plan management is aware that an event has occurred that may affect the value of the contract (for example, a decline in the creditworthiness of the contract issuer or third-party guarantor or the possibility of premature termination of the contract by the plan), pursuant to FASB Statement No. 5, *Accounting for Contingencies*, disclosure of the event or, in certain circumstances, reporting the investment at less than contract value may be appropriate.

4.14 *Benefit responsiveness* is the extent to which a contract's terms permit and require withdrawals at contract value for benefit payments, loans, or transfers to other investment options offered to the participant by the plan. Investment contracts must transfer the risk of principal and accrued interest to a financially responsible third party (that is, they provide for all participant-initiated transactions permitted by an ongoing plan at contract value with no conditions, limits, or restrictions) to be considered fully benefit responsive. The plan itself must also allow plan participants reasonable access to their funds. If access to funds is substantially restricted by plan provisions, investment contracts held by those plans may not be considered to be fully benefit responsive. For example, if plan participants are allowed access at contract value to all or a portion of their account balances only upon termination of their participation in the plan, it would not be considered reasonable access and, therefore, investment contracts held by that plan would generally not be deemed to be fully benefit responsive. If, however, a plan limits participants' access to their account balances to certain specified times during the plan year (for example, semiannually or quarterly) to control administrative costs of the plan, that limitation generally would not affect the benefit responsiveness of the investment contracts held by that plan. Contracts that provide for prospective interest adjustments may still be fully benefit responsive provided that the terms of the contracts specify that the crediting interest rate cannot be less than zero.

j. Paragraph 4.11 is renumbered as paragraph 4.15.

k. The phrase *contracts with insurance companies* in paragraph 4.25a is replaced by *insurance contracts*.

l. The following is added to paragraph 4.26:

   i. For benefit responsive investment contracts held by defined-contribution health and welfare plans, in the aggregate by investment option —

      - The average yield for each period for which a statement of net assets available for benefits is presented.

      - The crediting interest rate as of the date of each statement of net assets available for benefits presented.

      - The amount of valuation reserves recorded to adjust contract amounts (for example, due to problems with the creditworthiness of the contract issuer or third-party guarantor).

   j. A general description of the basis and frequency of determining crediting interest rate resets and any minimum crediting interest rate under the terms of the contracts and any limitations on guarantees (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives) on benefit responsive investment contracts.

m. The heading that precedes paragraph 7.23, *Insurance Contracts*, is replaced by *Contracts With Insurance Companies*.

n. The second sentence in footnote 32 to paragraph 7.36 is replaced by the following:

   A plan's share would be the fair value of its units determined in accordance with applicable guidance for valuing investment contracts, and the funds held in the separate account should be viewed as an unallocated funding arrangement.

o. The last sentence of paragraph 7.37 is replaced by the following:

   These contracts are unallocated and are to be included as plan assets at their fair values.

p. The phrase *insurance contracts* in paragraph 7.38a is replaced by *contracts with insurance companies*.

q. The phrase *insurance contracts* in paragraph 7.39 is replaced by *contracts with insurance companies*.

r. The third bullet of paragraph 7.39b is replaced by the following:

   — The fair value of the funds in the general or separate account at the plan's year-end and the basis for determining such value

s. The appendix of this SOP, *Application of Fair Value and Contract Value Reporting for Defined-Contribution Plan Investments*, is added as appendix I.

AMENDMENT TO SOP 92-6

16. SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans* is amended as follows:

a. The parenthetical comment *(excluding contracts with insurance companies)* in paragraph 25 is replaced by *(excluding insurance contracts and fully benefit responsive investment contracts held by defined-contribution health and welfare benefit plans)*.

b. Paragraph 26 is replaced by the following:

> Insurance contracts, as defined by FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, should be presented in the same manner as specified in the annual report filed by the plan with certain governmental agencies pursuant to ERISA; that is, either at fair value or at amounts determined by the insurance enterprise (contract value). Plans not subject to ERISA should present insurance contracts as if the plans were subject to the reporting requirements of ERISA.

c. The following paragraphs are inserted as paragraphs 27, 28, 29, and 30:

> 27. Investment contracts held by defined-benefit health and welfare benefit plans should be reported at their fair values.
>
> 28. Defined-contribution health and welfare benefit plans provide benefits based on the amounts contributed to employees' individual accounts plus or minus forfeitures, investment experience, and administrative expenses. In such plans, plan participants have a vested interest in monitoring the financial condition and operations of the plan since they bear investment risk under these plans, and plan transactions can directly affect their benefits (for example, investment mix, and risk and return).
>
> 29. Plan assets of defined-contribution health and welfare benefit plans should be measured and reported at values that are meaningful to financial statement users including plan participants. The *contract value* of a *fully benefit responsive* investment contract held by a defined-contribution health and welfare benefit plan is the amount a participant would receive if he or she were to initiate transactions under the terms of the ongoing plan. Defined-contribution health and welfare benefit plans should report fully benefit responsive investment contracts at contract value, which may or may not be equal to fair value. If, however, plan management is aware that an event has occurred that may affect the value of the contract (for example, a decline in the creditworthiness of the contract issuer or third-party guarantor or the possibility of premature termination of the contract by the plan), pursuant to FASB Statement No. 5, *Accounting for Contingencies*, disclosure of the event or, in certain circumstances, reporting the investment at less than contract value may be appropriate.
>
> 30. *Benefit responsiveness* is the extent to which a contract's terms permit and require withdrawals at contract value for benefit payments, loans, or transfers to other investment options offered to the participant by the plan. Investment contracts must transfer the risk of principal and accrued interest to

a financially responsible third party (that is, they provide for all participant-initiated transactions permitted by an ongoing plan at contract value with no conditions, limits, or restrictions) to be considered fully benefit responsive. The plan itself must also allow plan participants reasonable access to their funds. If access to funds is substantially restricted by plan provisions, investment contracts held by those plans may not be considered to be fully benefit responsive. For example, if plan participants are allowed access at contract value to all or a portion of their account balances only upon termination of their participation in the plan, it would not be considered reasonable access and, therefore, investment contracts held by that plan would generally not be deemed to be fully benefit responsive. If, however, a plan limits participants' access to their account balances to certain specified times during the plan year (for example, semiannually or quarterly) to control the administrative costs of the plan, that limitation generally would not affect the benefit responsiveness of the investment contracts held by that plan. Contracts that provide for prospective interest adjustments may still be fully benefit responsive provided that the terms of the contracts specify that the crediting interest rate cannot be less than zero.

d. Paragraph 27 is renumbered as paragraph 31.

e. The following is added to paragraph 53:

- For benefit responsive investment contracts in the aggregate by investment option:
  - The average yield for each period for which a statement of net assets available for benefits is presented.
  - The crediting interest rate as of the date of each statement of net assets available for benefits presented.
  - The amount of valuation reserves recorded to adjust contract amounts (for example, due to problems with the creditworthiness of the contract issuer or third-party guarantor).
- A general description of the basis and frequency of determining crediting interest rate resets and any minimum crediting interest rate under the terms of the contracts and any limitations on guarantees (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives) on benefit responsive investment contracts.

EFFECTIVE DATE AND TRANSITION

17. This SOP is effective for financial statements for plan years beginning after December 15, 1993. Accounting changes adopted to conform to the provisions of this SOP should be made as of the beginning of the year in which the change is adopted. The financial statements should disclose the fact of the change and the effect of the change on the financial statements. Restatement of financial statements of prior years is not permitted.

APPENDIX

APPLICATION OF FAIR VALUE AND CONTRACT VALUE REPORTING FOR DEFINED-CONTRIBUTION PLAN INVESTMENTS

A.1 Fully benefit responsive investment contracts held by defined-contribution plans, including both health and welfare, and pension plans, that provide a guarantee by a financially responsible third party of principal and previously accrued interest for participant-initiated liquidations, transfers, loans, or hardship withdrawals under the terms of the ongoing plan, should be reported at contract value, which may or may not be equal to fair value. If access to funds is substantially restricted by plan provisions, investment contracts held by those plans may not be considered to be fully benefit responsive. Other investment contracts should generally be reported at fair value.

A.2 Investment contracts that do not provide a guarantee as discussed in paragraph A.1 may be valued by discounting the related cash flows based on current yields of similar investments with comparable durations. In determining the similarity of investments, appropriate consideration should be given to the credit quality of the contract issuer. Generally, contract termination (penalty) clauses need not be considered absent information that would indicate the plan's intent to terminate the contract.

A.3 In the following examples, value is determined within the context of the objectives of financial statements for a defined-contribution plan. The valuation must reflect the ability of the plan to pay benefits from the perspective of the participants. This value is then reflected on participants' statements to disclose the amount they can expect to receive when they exercise their rights to withdraw, borrow, or transfer funds under the terms of the plan.

Example 1: A five-year public bond (or portfolio of bonds) which is guaranteed by a third party to have a fixed value at the end of three years.

A.4 The guarantee applies only to the extent that the bond (or portfolio) is not liquidated prior to the end of three years. Liquidation within three years is at market value.

A.5 Because guaranteed proceeds from the bond are not available for benefit withdrawals or transfers prior to maturity, the contract should be valued at fair value. Fair value may be determined as the amount at which the bond could be exchanged in a current transaction between parties, other than in a forced or liquidation sale, considering the guaranteed fixed value of the bond at the end of three years.

Example 2: A benefit responsive investment contract.

A.6 This contract provides a fixed crediting interest rate, and a financially responsible entity guarantees liquidity at contract value prior to maturity for any and all participant-initiated benefit withdrawals, loans, or transfers arising under the terms of the plan, which allows access for all participants on a quarterly basis.

A.7 The contract should be reported at contract value, because the plan will receive such value and only such value if the contract is accessed to pay participant benefits or transfers.

A.8 The contract described in the preceding would be viewed as fully benefit responsive. Examples of some variations on this contract, and their impact on the valuation, follow.

a. *Liquidity at contract value is not guaranteed for benefits that are attributable to termination of the plan, a plan spin-off to a new employer plan, or amendments to plan provisions.* The contract should be reported at contract value unless it is probable that the plan will be terminated, spun off, or amended.

b. *Liquidity at contract value is not guaranteed for benefits that are attributable to the layoff of a large group of workers or an early retirement program.* The contract should be reported at contract value unless it is probable that termination of the employment of a significant number of employees will occur.

c. *The contract will pay for benefits of up to 30 percent of the contract at contract value, and any excess benefits will be at some adjusted value.* The contract should be reported at fair value. Fair value may be determined as the guaranteed amount plus the estimated discounted cash flows of the residual amount.

d. *The contract will pay benefits at contract value, but only if the issuer of the contract determines that there is sufficient liquidity in the portfolio of assets that backs the contract.* Because the third party has not guaranteed liquidity for participant-initiated withdrawals, the contract should be reported at fair value.

Example 3: A five-year, nonbenefit responsive investment contract that has no liquid market for trading.

A.9 The contract should be reported at fair value because there is no guarantee of liquidity at contract value. Fair value would be determined in the same manner as for an illiquid bond. FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, includes a discussion of methods used to determine the fair values of illiquid instruments.

Example 4: A benefit responsive, participating, separate account investment contract.

A.10 A financially responsible issuer pays contract value for participant withdrawals, regardless of the value of the assets in the separate account. The credited interest rate is a function of the relationship between the contract value and the value of the assets in the separate account. The rate is reset periodically, daily, monthly, quarterly, and so on, by the issuer and cannot be less than zero. There may or may not be a specified maturity date on the contract. The contractholder may terminate the contract at any time, and receive the value of the assets in the separate account.

A.11 The contract should be reported at contract value because participants are guaranteed return of principal and accrued interest.

Example 5: A synthetic investment contract — "managed" type.

A.12 This contract operates similar to a separate account GIC, except that the assets are placed in a trust (with ownership by the plan) rather than a separate account of the issuer and a financially responsible third party issues a *wrapper* contract that provides that participants can, and must, execute plan transactions at contract value.

A.13 Inasmuch as trust assets are owned by the plan, the wrapper contract and the assets in trust should be separately valued and disclosed. The wrapper contract would be valued at the difference between the fair value of the trust assets and the contract value attributable by the wrapper to such assets. When considered together, the trust assets and the wrapper contract should be reported at the wrapper contract value because participants are guaranteed return of principal and accrued interest.

Example 6: A synthetic investment contract — "repurchase" type.

A.14 Under this contract, the plan purchases a bond and places it in trust. The plan then contracts with a financially responsible third party to provide benefit responsiveness. Under the contract, should the bond need to be sold to meet a participant-initiated withdrawal benefit, loan, or transfer, the plan is obligated to sell the bond to the contract issuer, and the issuer is obligated to buy the bond. The transaction price is defined under the contract (for example, amortized cost). The issuer is not obligated, however, to purchase securities that are in default.

A.15 The contract, when considered together with the bond, should be reported at contract value (refer to paragraph A.13) absent impairment of the value of the securities due to credit risk because return of principal and accrued interest has been guaranteed to participants.

A.16 If the contract provided only an *option* for the sponsor to sell the bond to the issuer, rather than an obligation to do so, contract value would only apply when the fair value of the bond was less than contract value, because the option would then have value. Fair value may be determined as the greater of the estimated discounted cash flows or the option price.